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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000620

SIPDIS

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TAGS: [PREL](#) [ECON](#) [EFIN](#) [RS](#) [ZK](#)
SUBJECT: RUSSIA TRADES LOANS FOR PRESTIGE IN THE CIS AMID
DEEPENING FINANCIAL CRISIS

REF: A. MOSCOW 220
[1](#)B. BISHKEK 102

Classified By: Ambassador John R. Beyrle for reasons 1.4 (b) and (d)

[1](#)1. (C) Summary. Despite its own increasing financial woes, the Russian government has recently pledged economic assistance to Kyrgyzstan, Belarus and Armenia, as well as \$7.5 billion to a new Eurasian Economic Community (EurAsEc) anti-crisis fund. Discussions with Ukraine and Tajikistan on financial aid are reportedly also ongoing. While Moscow has not disclosed the terms of its assistance packages to the CIS countries, speculation about the strings attached is rampant.

Regardless of the specific short term quid pro quos the Russians may have extracted from their beneficiaries, Russia's use of financial assistance underscores its wish to maintain long term prestige and influence in the CIS space, where Moscow views its traditional strategic interests as its foreign policy priority. Given the significant Russian commercial interests in the region, the GOR is also looking to help prevent a collapse of the CIS economies that would have detrimental effects on its own economy. It remains to be seen, however, whether the GOR can fully fund its various assistance pledges given the ongoing internal policy logjam on the federal budget and the government's dwindling resources. End Summary

Russia Opens Its Wallet...

[1](#)2. (SBU) The March 3 MFA report on Russian foreign policy and diplomatic activities in 2008 unambiguously states that Russia considers its nearest geopolitical environment, particularly the CIS, as its "absolute foreign policy priority," where the country has "traditional strategic interests." This echoes recent statements by top Russian officials, including President Medvedev and Foreign Minister Lavrov, regarding Moscow's "mutually privileged relations" with its former Soviet republics (Ref A). As the repercussions of the global financial crisis reverberate increasingly and alarmingly throughout the region, the GOR has, on paper at least, put its money where its mouth is, announcing a series of aid packages to CIS countries that include: a \$2.3 billion assistance package to Kyrgyzstan, a \$2 billion loan to Belarus, a \$7.5 billion contribution to the newly created \$10 billion EurAsEc anti-crisis fund, and a \$500 million package to Armenia. A \$5 billion emergency assistance loan to Ukraine to cover the budget deficit is currently under discussion along with an additional \$3 billion assistance package for Belarus, while the Tajik government has reportedly sought "urgent humanitarian assistance" from Russia. Although Tajik President Emomali Rahmon's February 24-25 visit to Moscow did not yield any announcements, he and President Medvedev reportedly discussed cooperation in energy projects and in the 670-megawatt Sangtuda-1 hydro electric power plant, a \$720 million project in which Russia has a 83.55% stake.

13. (C) Details on all of these packages are sketchy. Piecing together reporting from various sources, it would appear the \$2 billion to Belarus and the \$500 million to Armenia are straight loans with possible ongoing discussions on the two countries' entering the ruble zone. The loans are reportedly at a slightly better than market rate. Similar financial assistance from Moscow in the past had involved 15-year repayment schedules with an initial 4-year grace period, as well as the takeover of Armenian state assets by Russian companies. As Embassy Bishkek reported in Ref B, the structure of the \$2.3 billion package to Kyrgyzstan is more complicated and might not put as big a dent in Russia's wallet than first meets the eye. A big chunk of the amount is a \$1.7 billion loan to help finance the construction of the Kambarata 1 hydroelectric dam, the terms of which are still to be negotiated. The rest consists of the write off of approximately \$150 million in existing Kyrgyz debt to Russia, a \$150 million grant to be disbursed by the Russian government, and a \$300 million loan in budgetary support. The GOR reportedly promised to disburse the latter two pots of money, amounting to \$450 million total, by April 30.

...With Strings Attached

14. (C) While the exact terms of the GOR's aid offers to the former Soviet republics are shrouded in secrecy, speculation over the political and economic strings attached runs rampant. Among the packages, the financial aid to Kyrgyzstan has attracted by far the most attention amidst rumored Kremlin pressure for Bishkek to close the Manas air base. Similarly, commentators have speculated that the GOR has

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delayed delivery of the second tranche of its \$2 billion loan to Belarus because of Belarusian reluctance to fulfill its promise to recognize South Ossetia and Abkhazia in the face of EU pressure (N.B. According to March 13 press reports, the GOR may have now provided \$500 million of the \$1 billion second tranche funds). In the wake of President Rahmon's visit, Russian press was abuzz with speculation that Moscow had not offered Tajikistan a package similar to Kyrgyzstan's due to Rahmon's failure to give Russia a controlling stake in the Rogun hydroelectricity project, for which \$800 million in Russian investment is being sought, and his foot dragging on moving a Russian air base from its current Dushanbe Airport location to a new site as per a 2004 agreement between the two governments. With regard to the \$5 billion loan to Ukraine that is currently under discussion, experts assume Russia at a minimum wants to ensure that its interests in Ukraine would continue to be served by providing Prime Minister Tymoshenko with the credit "win" in advance of the presidential elections. While the media has speculated over specific demands such as gaining control over Ukraine's gas transit pipelines or Ukraine's abandoning its NATO aspirations, many experts and EU diplomats believe Russia can score a soft power victory by supporting Ukraine at a time when the EU and the international financial institutions are not seen to be delivering. Little is known about the aid offer to Armenia, which could be a balancing factor to Russia's recent overtures to Azerbaijan in view of that country's hydrocarbon resources.

Political and Economic Benefits for Russia

15. (C) While the GOR may be utilizing its assistance packages to extract specific short term concessions from its neighboring countries, its largess at a time when its own economy is increasingly slipping toward a recession is also based on long term strategic interests. For a region prone to playing the balance of power game, many of the former Soviet republics still look toward Russia as the de facto dominant player, but are increasingly seeking to play off Moscow against other players such as Beijing, Washington, and Brussels (Ref A). The GOR, despite its formal renunciations

of the "zero-sum" game, understands this reality well and thus is under pressure to open its wallet in order to maintain its prestige and special interests in the region, as well as to ensure its neighbors' good will toward Russia. The situation is complicated by the fact that as the Russian economy contracts and the number of officially registered unemployed is expected to reach almost 3 million by the end of the year, CIS members are hurting from the loss of remittance payments that millions of migrant workers send home from their construction and retail jobs in Russia. Central Asian leaders, in particular, are looking toward Moscow to remedy the situation.

¶6. (C) Russian assistance to the CIS countries also serves Moscow's own economic interests. Deputy Director of the CIS Institute Andrey Grozin points out that prestige and influence aside, stability in the post Soviet space is a top priority for the Russian government. Given the significant Russian business and trade interests with the former Soviet republics, particularly with regard to oil and gas in the Central Asian countries, a collapse of the CIS economies would be potentially disastrous to the already troubled Russian economy. The Ministry of Economic Development's Chief of the CIS Economic Cooperation Department Sergey Chernyshev agrees, stating that measures some CIS governments have already taken, including tightening monetary policies and cutting budget spending and investments into the real sector, could harm the financing of projects that involve Russian investors.

But Does Russia Have the Money?

¶7. (C) The current \$64,000 question is whether the Russian government can fulfill its various assistance obligations given its own economic woes. The reality is that the Russian economy is increasingly feeling the effects of the ongoing financial crisis, and the federal budget is no exception. After more than two months of intense negotiations, Cabinet ministers still have not reached a consensus on expenditures in their effort to implement Prime Minister Putin's December, 2008 call for a revised 2009 federal budget. The inter-ministerial disagreements have taken shape against a backdrop of an expected 40-percent drop in revenues relative to the original budget. There are apparently inflexible positions within the Russian government about the best use of budget resources to mitigate the expected contraction. One indication of the seriousness of the budget crisis is that

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the government is asking Rosnanotech and other state corporations to return previously disbursed government funds.

¶8. (C) Many experts believe that given the protracted budget debate and the GOR's dwindling resources, Russia is unlikely to fulfill all the assistance commitments that it has made to its neighbors in recent months. Lena Lebedinskaya, a federal budget specialist at the Economic Experts Group consultancy to the Finance Ministry, told us certain programs under the budget's "National Security" heading could be restructured to allow for the disbursement of initial tranches this year but possibly at a fraction of the originally proposed amount. She speculated that these proposed loans would suffer the same fate of non-implementation that befell other Russian government crisis-mitigation measures, such as the \$50 billion foreign debt repayment fund from which Vnesheconombank (VEB) ultimately distributed only \$11 billion before the GOR discontinued the program.

Comment

¶9. (C) While Russia may desire to use its economic resources to play a more controlling role in the affairs of

its neighbors, its own mounting economic problems may complicate its ability to carry out its commitments. GOR reserves are now being committed to an ever growing budget deficit and Russia faces the likelihood of renewed external borrowing in 2010, if not before, at high interest rates. At the same time, the assistance pledged to the various CIS countries are relatively small in amount vis-a-vis their economies' growing need for external bailout. With countries such as Ukraine, Belarus, and Tajikistan reportedly also looking elsewhere for funds to weather the current storm, Russian attempts to buy prestige and influence may not yield as much return as the GOR has initially hoped. Whether for political or budgetary reasons, the GOR has already missed the reported February deadline for providing the full second tranche of loans to Belarus. The next test will be whether it will provide Kyrgyzstan the \$450 million first tranche by the April 30 deadline, especially in light of Bishkek's apparent willingness to consider a new contract for the U.S. use of the Manas air base.

BEYRLE